# Russia's Economy: Between a Crash and a Hard Landing

Yakovlev, Andrei

Veröffentlichungsversion / Published Version
Zeitschriftenartikel / journal article

**Empfohlene Zitierung / Suggested Citation:**
Yakovlev, A. (2022). Russia's Economy: Between a Crash and a Hard Landing. *Russian Analytical Digest*, 283, 7-9. https://doi.org/10.3929/ethz-b-000542143

scenario. At the same time, states such as Iran, Venezuela, and North Korea demonstrate in different ways that a long and severe economic crisis resulting from sanctions need not bring about a complete regime collapse, a change of power, or a less aggressive foreign policy.

If the shifting of state borders through unprovoked war and the indiscriminate destruction of civilian targets are not to again become the continuation of politics by other means, then the price for this strategy must now be raised as dramatically and as quickly as possible. The greater the economic pressure through sanctions and perhaps also the moral pressure through proscription, the greater the chance that there will be opposition to the war in various quarters in Russia. The quicker the pressure is applied, the smaller Russia's possibilities of cushioning it or gradually adapting.

*About the Author*
*Heiko Pleines* is head of the Department of Politics and Economics, Research Centre for East European Studies and Professor of Comparative Politics at the University of Bremen.

ANALYSIS

# Russia's Economy: Between a Crash and a Hard Landing

By Andrei Yakovlev

DOI: 10.3929/ethz-b-000542143

## Abstract
Based on macro-level data, most analysts forecasting Russia's economic development following the introduction of new large-scale sanctions expect a 10–12% drop in GDP, 20–25% inflation, and an increase in unemployment from 4.4% to 7–8% by the end of this year. This article argues that in the context of a severe economic shock, micro-data and comparison with similar cases offer a better guide to future developments than macro-data. They point to a much sharper decline in economic activity than is currently being forecasted.

## Introduction
Commenting on the prospects of the Russian economy following the imposition of new large-scale international sanctions in relation to the invasion of Ukraine, most analysts (including representatives of European banks) expect a 10–12% drop in GDP, 20–25% inflation, and an increase in unemployment from 4.4% to 7–8% by the end of this year. Obviously, these estimates are based on macro-data about the state of the Russian economy before the imposition of sanctions and tend to rely on the fairly mild negative consequences of recent crises: in 2014–2015 after the first wave of international sanctions was introduced, and in 2020–2021 amid the Covid-19 pandemic.

## Challenges of Economic Forecasts
The peculiarity of such macro-estimates, especially when it comes to deep shocks, is that they can overestimate the significance of trends that developed before the crisis and underestimate changes in the expectations and strategies of economic agents at the micro-level. One striking example of this is Russia's default and devaluation of the ruble in August 1998, after which no macroeconomists predicted the rapid disappearance of bartering, a financial recovery, and rapid economic growth. In October 1999 McKinsey's famous report "Russian Economy: Growth is Possible" was the first to suggest that Russia could grow at an annual rate of 7–8% and double its GDP in 10 years. This conclusion was based on a case study of 10 major sectors of the Russian economy (from ferrous metallurgy and the cement industry to retail and the IT sector), with an analysis of productivity growth factors and firm strategies—that is, on micro-level data.

Currently, the Russian economy shows similar features, but they point in the opposite direction. As one entrepreneur told me in a personal conversation, at the end of February and the beginning of March his company, which produces electrical equipment, was operating at higher-than-usual capacity because consumers were trying to buy products to store. It was obvious that demand would fall later, but new forecasts could be made only "when the dust settles from the collapse of what is crumbling now."

When nevertheless trying to attempt a general forecast of Russia's economic development, it makes sense not only to try to understand how the current situation differs from the recent Russian crises mentioned above, but also to draw a comparison with Iran, which has been able to maintain its economy amid years of harsh international sanctions, and with the Soviet economic model, which from the outset focused on isolation from the world market.

## Comparisons

The abrupt breakdown of supply chains (resulting from the decision of many foreign companies to stop production in Russia and from import restrictions on parts and components due to international sanctions), the devaluation of the ruble and restrictions on its convertibility, as well as the loss of access to half of the gold and foreign currency reserves held by the Ministry of Finance and the Central Bank, give rise to analogies to the shock transition of the Soviet planned economy to a market economy in 1991–1992. However, there are significant differences. Despite the continued notable interference of the state, Russia's economy has become a market economy—and therefore economic agents are much more likely to adapt to the new conditions. Moreover, the state apparatus remains generally capable of governing—in contrast to the actual collapse of the state in 1991–1992.

In this sense, the current situation in Russia may be closer to that of Iran, where the economy at the time of the first sanctions was market-based and the government (especially in the 2010s, during the height of tensions with the United States and the EU) was generally able to control economic processes. However, an important difference between Iran and Russia is the much greater integration of the latter into global markets. Starting in the early 2000s, the modernization of many sectors of the Russian economy relied on the use of foreign technology and imported equipment. Modernization processes thus involved cooperation with foreign investors who were interested in access to the Russian market. With their help, Russian firms were integrated into global value chains. The result was an increase in productivity at Russian enterprises and a significant improvement in the quality of their products. At the same time, however, these modernized enterprises turned out to be dependent on imported parts and components, as well as equipment maintenance (in those cases when domestic raw materials and materials were used for production). The most striking examples of this kind of dependence are the aircraft and car industries, which are singled out by all experts as the most affected industries. Importantly, however, the same is also true of equipment in the fields of metallurgy, chemistry, oil refining, and even agriculture (concerning seed imports).

In other words, Iran's economy faced sanctions (and the need to build an autonomous economic model) back in the 1980s, at the very beginning of the current wave of globalization. During this period, most national economies were still relatively autonomous and it was easier for Iran to build its "resistance economy." At the same time, the Iranian economy was—and still is—less complicated than the Russian economy in terms of its structure. In fact, Iran rejected the benefits of globalization, which allowed the country to maintain its economic independence. This did, however, come at the price of stagnation and a lack of economic development—as a result, it took Iran until 2017 to return the level of GDP per capita it had achieved in 1979.

Russia differs from Iran in its high degree of integration into global markets since the beginning of the reforms of the 1990s and the growth of this integration in the 2000s. In the last ten years (especially since 2014), the Russian government has actively supported import-substitution processes—but the globalization processes of the 1990s and 2000s mean that national economies have objectively become interdependent. Today, no state in the world that participates in global value chains (including the US and China) can switch to a self-sufficient mode of production without a radical reduction in its volume and range of products manufactured. This is the problem Russia will have to face in the coming months. The scale of this problem for Russia is exacerbated by the phenomenon of "private sanctions," where companies break contracts with Russian consumers not only because of sanctions imposed by their national governments, but also on their own initiative.

## Outlook

Since we are talking about thousands of companies from different countries, it is currently very difficult to assess the consequences of such "private sanctions." However, contacts with entrepreneurs show that at many machine-building enterprises, the available stocks of parts and components are sufficient to maintain production only for 1.5–2 months—after which a shutdown of these enterprises will begin, with inevitable knock-on effects for their suppliers and customers. The solution to this problem (which is already being discussed at the enterprise level) is the resumption of production models developed during the Soviet era and taken out of commission 10–15 years ago. In practice, this will mean that after the inevitable deep recession (which may be comparable to the decline in production in 1992–1993), enterprises will adapt to the new conditions by reducing the range and quality of products they produce (especially technically complex ones).

An additional factor that may increase the depth of the decline is the fact that the Russian government did not seem to be prepared for the introduction of such large-scale sanctions (and especially for the imposition of "private sanctions" by thousands of international suppliers). Apparently, based on the experience of 2014, the government expected rather limited sanctions from the US and the EU. The 2014 sanctions were certainly painful but did not lead to radical destruction of the supply chain. Without fully understanding the real scale of losses resulting from the stoppage of import supplies (as well as not daring to admit this to their superiors), industry agencies are still guided in the elaboration of anti-crisis measures by the experience of 2020, when the government managed to mitigate the negative effects of the interruption of supplies during the Covid-19 pandemic. But these measures will probably not have the desired effect today, as they were focused on supporting enterprises during the lockdown and assumed the resumption of supplies in the future. Government officials are now pinning their hopes on Chinese firms being able to replace European and American suppliers. However, many companies are skeptical about this and see such opportunities only in the medium to long term.

Another important difference from 2020 is that back then, the development of adequate anti-crisis measures was the result of an active dialogue between the government and business. Such a dialogue was possible, among other things, because the crisis was caused by external factors beyond the government's control. Government officials and business were in the same boat caught in the storm, and they were equally interested in finding economic policy instruments that would allow them to weather the storm with minimal losses. The current crisis has clearly been created by the actions of the government, as a result of which officials are switching to direct administrative regulation of market processes instead of dialogue. A striking illustration of this is the Ministry of Industry and Trade meeting with metallurgists in early March (see https://www.youtube.com/watch?v=d11_DDdgdQA), where it was expressly stated that in the event that prices increased beyond the limit "recommended" by the ministry, enterprises would face inspections by the prosecutor's office and criminal investigations. Such administrative measures can stabilize the market for a short time (as occurred in the currency market following the freezing of deposits and the introduction of restrictions on purchases of foreign currencies). However, such measures undermine the functioning of market mechanisms and will prevent the economy from adapting to new conditions.

## Conclusion

Overall, the Russian economy today can be compared to an airplane whose captain makes decisions while under the influence of narcotics. At the same time, the plane is running out of fuel—but only part of the crew understands this so far, and most of the passengers and the other part of the crew are not yet aware of what is happening. Further developments will depend on whether the informed part of the crew manages to keep the captain from making more dangerous turns and whether that part of the crew is then able to land the plane.

These kinds of metaphorical comparisons do not provide a basis for quantitative estimates, but it seems to me that the macroeconomic forecasts mentioned at the beginning of this commentary are overly optimistic and that economic dynamics in Russia in 2022 will be close to what we saw in 1992–1993. The social and political consequences of such a scenario should be the subject of a separate discussion.

*About the Author*

Dr. *Andrei Yakovlev* is one of the leading Russian experts in industrial policy, corporate governance, and state-business relations. He participated in the elaboration of "Strategy-2020" in 2010–2011 and was awarded the Gaidar Memorial Prize in Economics in 2017.